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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 17

ROBERT J. DECKERT, ROLAND W. RANDAL, DAVID W. COMPTON, ET AL.,

Petitioners,

vs.

INDEPENDENCE SHARES CORPORATION, ALFRED H. GEARY, FRANK McCOWN, JR., ET AL.

No. 18

ROBERT J. DECKERT, ROLAND W. RANDAL, DAVID W. COMPTON, ET AL.,

Petitioners,

vs.

THE PENNSYLVANIA COMPANY FOR INSURANCES ON LIVES AND GRANTING ANNUITIES.

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR PETITIONERS.

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BRIEF FOR PETITIONERS.

Opinions Below.

The opinions of the courts below are reported in *Deckert, et al.,* v. *Independence Shares Corporation, et al.,* 27 F. Supp. 763 (D. C. E. D. Pa., 1939); *Independence Shares Corporation, et al.,* v. *Deckert, et al.; The Pennsylvania*

Company for Insurances on Lives and Granting Annuities, et al., v. *Deckert, et al.*, 108 F. (2d) 51 (C. C. A. 3rd, 1939).

Jurisdiction.

The date of the opinion of the Circuit Court of Appeals for the Third Circuit to be reviewed is November 11, 1939, and the date of the denial by the Circuit Court of appellants' petition for rehearing is December 20, 1939. The petition for writs of certiorari was filed on February 17, 1940, as of October Term, 1939, Nos. 733, 734, and was granted on March 25, 1940, as of October Term, 1940, Nos. 17, 18.

The jurisdiction of this Court is invoked under the provisions of Section 240 (a) of the Judicial Code, as amended (March 3, 1891, c. 517, Sec. 6, 26 Stat. 828, as amended; 28 U. S. C. 347 (a)).

Questions Presented.

1. Where an investment trust stock-selling scheme is fraudulent *per se*, and the vendor of said stock is insolvent, and the assets of said trust are being wasted and dissipated, and a multiplicity of suits by defrauded purchasers, with consequent inequitable preferences, is threatened and probable, does a district court of the United States, by virtue of the provisions of the Securities Act and the Judicial Code, have equitable jurisdiction over a class action brought by defrauded purchasers for the rescission of the sales of said securities, the revocation of the trusts in the underlying assets, the recovery of the consideration paid for said securities, and the appointment of a receiver to make an accounting of the assets, liabilities and transactions of the vendor, to bring suit against the wrongdoers, and to recover, liquidate and distribute the trust assets equitably among all persons entitled thereto?

2. In such a case, where the trust assets are held by a bank as nominal trustee thereof, and the bank in reality is but a custodian and bookkeeper, and all control, management, investment and reinvestment of the said assets are specifically vested in said vendor, and said class action prays that the bank be directed to turn over said assets to said receiver and that it be enjoined from paying over to said vendor any monies or assets belonging to purchasers, is said bank a necessary party defendant in said action?

3. In such a case, may the district court, pending litigation, enjoin the payment by the bank to, and the receipt by, said fraudulent insolvent vendor of a large sum of money belonging to purchasers?

Statutes Involved.

The statutes involved herein are Section 24 of the Judicial Code, as amended (March 3, 1875, c. 137, Sec. 1, 18 Stat. 470, 28 U. S. C. 41) and the Securities Act of 1933, as amended (May 27, 1933, c. 38, Title I, 48 Stat. 74 as amended; 15 U. S. C. 77a-z).

Statement of Case.

On March 11, 1939, plaintiff planholders filed a class action under the general equitable jurisdiction granted by the Judicial Code and Securities Act in the United States District Court for the Eastern District of Pennsylvania against the defendants: Independence Shares Corporation, a trust and investment corporation (hereinafter referred to as "Independence"); Alfred H. Geary, Frank McCown, Jr., Robert E. Bonner, Horace M. Barba, and Eckley B. Coxe, 3d, officers and directors of Independence; and The Pennsylvania Company for Insurances on Lives and Granting Annuities, a bank (hereinafter referred to as "Pennsylvania Company").

The complaint alleges that:

(a) Independence and its predecessor, Capital Savings Plan, Inc. (hereinafter referred to as "Capital"), in the sale of savings plan contract certificates, trust shares, and purchase plans, to the plaintiffs and many others, by the use and means of instruments of transportation and communication in interstate commerce and by the use of the mails, had defrauded them of both money and property, by means of untrue statements, misrepresentations and concealments, in violation of the Securities Act;

(b) The Pennsylvania Company, as trustee, collected the payments from planholders, made certain deductions therefrom, and invested the balances, under the instructions of Independence, in Independence Trust Shares for the accounts of the respective planholders. These trust shares were created by Independence and represented a 1/1000 interest in a portfolio consisting of one share of each of certain underlying stocks purchased by Independence for the creation of the said trust shares;

(c) A concealed, arbitrary "overwrite" or "load" was added to the price of the trust shares;

(d) Independence and its predecessor, Capital, consented to an injunction restraining their further violation of the Securities Act, pursuant to the prayers of a Bill in Equity filed against them by the Securities and Exchange Commission on June 22, 1938, charging violation of the said Act;

(e) Independence thereafter recognized and admitted a contingent liability, estimated by it to approximate $3,-500,000.00, arising out of the sales alleged herein to have been made in violation of the Securities Act;

(f) There has been adverse publicity causing a virtual cessation of business and sales of contract certificates and

purchase plans, although expenses, overhead and excessive fees continue, making impossible any profit to subscribers; and

(g) Independence is insolvent, and its funds and assets, and the trust assets held by the Pennsylvania Company, all of which are controlled by Independence, are being dissipated and wasted;

and prays that:

(a) A receiver be appointed for the defendant Independence with power to take into his possession all of its assets and all of the trust assets held by the Pennsylvania Company, and to liquidate and distribute the said assets among the persons entitled thereto (R. 4-33).

After the suit was instituted but before an answer was filed, two additional planholders, J. S. Van Sciver and James H. Irvin, each of whom had paid in, and were therefore entitled to receive more than, $3,000.00, were added as party plaintiffs by leave of court (R. 366).

After numerous hearings, District Judge Kalodner, on May 18, 1939, filed an opinion holding that the District Court had jurisdiction over this cause of action; that the "testimony overwhelmingly substantiated the allegations in the Bill of Complaint"; and that Independence was liable to subscribers for the money paid in by them (R. 336-363).

Specifically, the learned Chancellor found that many fraudulent and untrue statements and representations were made to planholders and prospective planholders by the defendant vendor, its officers and salesmen; that the defendant vendor and its officers gave written and verbal instructions to salesmen which directed them to use these fraudulent and untrue statements and representations; and that included in such fraudulent and untrue statements, representations, and concealments were the following:

(a) That the plan was a "savings plan" paying a high rate of interest;

(b) That the various arbitrary fees and charges made by Independence were much less than they were in fact;

(c) That the Pennsylvania Company was "in back of" the plan and "guaranteed" $2,000.00 at the end of ten years for each $1,200.00 paid in; and

(d) That the Pennsylvania Company was in sole and complete control of the "investment" of funds paid in by the planholders (R. 351-353).

Judge Kalodner further found that the allegations of dissipation of assets were substantiated by proof that the recent sale of seven of the underlying securities, and the subsequent reinvestment of the proceeds, with its contingent fees, resulted in a loss to planholders of $158,000.00, excluding the "overwrite" or "load" of $38,258.85, or a total loss to planholders of approximately 25% of the amount they paid in. Finding that this "overwrite" or "load" was not only concealed from planholders but was deliberately misrepresented to them, he enjoined the payment by the Pennsylvania Company to, and the receipt by, Independence of the $38,258.85 (R. 368). In addition, Judge Kalodner dismissed the motions to dismiss the action and referred the question of solvency or insolvency to a special master (R. 363).

Without challenging, denying or disputing the findings of the District Court, the defendants appealed from these orders to the Circuit Court of Appeals for the Third Circuit. Independence argued that the court lacked jurisdiction to entertain the cause and to enter the said orders. The Pennsylvania Company argued that since the Securities Act only authorized the recovery of a money judgment against the vendor, the Pennsylvania Company was not a proper

party defendant. The Pennsylvania Company also argued that since it, the trustee, was not charged with any fraud or wrongdoing, the court was powerless to reach or protect the trust *res* in its hands, even though the trust *res* had been procured by a stock selling scheme fraudulent *per se*.

The Circuit Court, on November 11, 1939, reversed the orders of the District Court. It agreed with the District Court that jurisdiction of the instant cause existed in the District Court by virtue of the provisions of the Securities Act; but without commenting upon or apparently considering the equities arising from the proved facts, or the equitable jurisdiction granted by the Judicial Code, or inherent in the District Court held that the Securities Act did not authorize the appointment of a receiver; that the present remedy of the plaintiffs is limited to a "civil action" at law to recover a money judgment against the vendor for the consideration paid; that the injunction against the Pennsylvania Company may, therefore, not be maintained; and dismissed the action as to the Pennsylvania Company (R. 380-385). Plaintiffs filed a petition for rehearing which the Circuit Court denied on December 20, 1939 (R. 391-392).

On February 17, 1940, appellants filed, and on March 25, 1940, this Court granted, a petition for writs of certiorari to the Circuit Court (R. 393).

Specifications of Errors to be Urged.

1. The Circuit Court erred in reversing the orders of the District Court.

2. The Circuit Court erred in dismissing this action as to the Pennsylvania Company.

3. The Circuit Court erred in holding that none of the prayers of the complaint asking for specific relief may be granted.

4. The Circuit Court erred in not holding that the District Court had equitable jurisdiction, under both the Judicial Code and the Securities Act, to hear and determine this cause and to grant the relief prayed for.

5. The Circuit Court erred in holding that the Securities Act does not authorize an application for the appointment of a receiver, but restricts defrauded purchasers to a "civil action" at law for the recovery of a money judgment against the vendor.

6. The Circuit Court erred in holding that a defrauded purchaser of securities from an investment trust may not, in equity, rescind the contract induced by fraud, avoid the trust and recover the money paid thereunder.

ARGUMENT.

I. Summary of Argument.

Briefly stated, this is the plaintiffs' case:

Independence, its predecessor, Capital, and their officers, sold certain securities called "contract certificates" and "purchase plans", to plaintiffs and other persons (hereinafter referred to as planholders) by means of certain fraudulent conduct, practices and misrepresentations forbidden by Section 12 of the Securities Act.

Section 12 provides that where securities have been sold by such fraud, the seller shall be liable to the buyer, *"who may sue either at law or in equity,* in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon."

The Act further provides in Section 22 (a) that *"the District Court shall have jurisdiction . . . of all suits in equity . . .* brought to enforce any liability or duty created by this [Act] . . ." and in Section 16 that *"the*

rights and remedies provided by this [Act] shall be in addition to any and all other rights and remedies that may exist at law or in equity."

Section 24 (1) (a) of the Judicial Code provides that "the district courts shall have original jurisdiction . . . of all suits of a civil nature at common law or in equity . . . where the matter in controversy exceeds, exclusive of interest and costs, the sum or value of $3,000.00 and . . . arises under the Constitution or laws of the United States . . ." Section 24 (8) provides that "the district courts shall have original jurisdiction . . . of all suits and proceedings arising under any law regulating commerce . . ."

Since the stock selling scheme was fraudulent *per se,* all planholders are entitled, under the quoted provisions of the Securities Act and the Judicial Code, to bring suits in equity in a district court to rescind sales of certificates, avoid the trusts created therein, and recover the money paid for the said securities with interest thereon.

The defendant vendor is, however, insolvent. Its assets are insufficient to satisfy the claims of all planholders. There is grave danger of continued waste and dissipation of these assets. Any recovery resulting from individual actions by planholders will constitute inequitable preferences to the prejudice of all other planholders. There being no adequate remedy at law, the situation requires the appointment of a receiver to make a proper accounting of the assets, liabilities and transactions of Independence, prevent threatened and probable multiplicity of suits, prevent dissipation and waste of assets equitably belonging to all planholders, safeguard and preserve the said assets, prevent inequitable preferences, bring suit against the wrongdoers, and distribute said assets equitably among all persons entitled thereto.

Plaintiff planholders, in compliance with the provisions of the Securities Act and Judicial Code, and to enforce the liability created by the Securities Act, commenced a class action for the appointment of a receiver to recover, liquidate and distribute, under the direction of the court, the assets equitably belonging to planholders.

The contract certificates and purchase plans created trusts in certain underlying stock held by the Pennsylvania Company and purchased with the money paid in by planholders. Under the terms of the trust, the Pennsylvania Company, although named therein as trustee, is actually but a custodian of the assets and a bookkeeper of the transactions connected therewith; the real trustee is and was the defendant Independence: as stated by Judge Kalodner, "Independence Shares Corporation had and exercised sole control of the securities in the trust and the Pennsylvania Company had no control or authority whatsoever over the securities" (R. 361).

Since the contract certificates and purchase plans are voided by fraud, the trusts are necessarily likewise voided. The Pennsylvania Company is today, therefore, the holder of but naked legal title to certain assets equitably owned by the planholders. The Pennsylvania Company is, therefore, a necessary party defendant to the instant action so that the court may direct it to turn these assets over to a representative of the court.

Under the direction of the court, therefore, the receiver will take into his possession these assets equitably belonging to planholders and held by the Pennsylvania Company and will distribute such assets to the planholders and will also proceed against Independence and such other persons as may be liable for the satisfaction of the rights given to planholders by the Securities Act and general equitable principles.

The court will determine the several rights of all planholders; the receiver will distribute the assets to the planholders entitled thereto; and thus all planholders will be treated equally and equitably.

II. Jurisdiction Exists Under Both the Judicial Code and the Securities Act.

The Circuit Court held that the District Court had jurisdiction over the controversy but restricted the jurisdiction to that granted under the provisions of Sections 12(2) and 22(a) of the Securities Act. The court decided, moreover, that under the Act the remedy of an aggrieved person lies exclusively in a "civil action" against the respondent vendor to recover the "consideration" paid by him, and therefore held that none of the prayers of the complaint asking for specific relief may be granted.

It is contended by plaintiffs that jurisdiction arises and exists by virtue of *both* the Judicial Code and the Securities Act and that *both* authorize the equitable relief here sought.

(a) Jurisdiction under the Judicial Code.

Jurisdiction exists over the instant cause of action in the United States District Court by virtue of the provisions of Section 24 of the Judicial Code which provides, *inter alia:*

> "The District Courts shall have original jurisdiction as follows:
>
> "First. Of all suits of a civil nature at common law or in equity . . . where the matter in controversy exceeds, exclusive of interest and costs, the sum or value of $3,000.00 and (a) arises under the Constitution or laws of the United States . . . .
>
> "The foregoing provisions as to the sum or value of the matter in controversy shall not be construed to apply to any of the cases mentioned in the succeeding paragraphs of this section . . .

"Eighth. Of all suits and proceedings arising under any law regulating commerce . . ."

It appears, therefore, that jurisdiction exists in the United States District Court (1) if the matter in controversy exceeds the sum of $3,000.00 and arises under the laws of the United States, or (2) if the suit arises under a law regulating commerce.

(1) The matter in controversy exceeds $3,000.00 since two of the plaintiffs, to wit, J. S. Van Sciver and James H. Irvin, have each paid in and therefore are entitled to receive more than $3,000.00 (R. 366). Further, it is well settled in the United States District Court for the Eastern District of Pennsylvania, where the instant suit was brought, that where a bill seeks the appointment of a receiver, the amount involved, for jurisdictional purposes, is not the amount of the plaintiffs' claims but the value of the receivership assets: *United States Radiator Company, et al.* v. *Doody, et al.*, 5 F. Supp. 471 (D. C. E. D. Pa., 1933); *Great Atlantic and Pacific Tea Co.* v. *A. and P. Cleaners and Dyers, Inc.*, 10 F. Supp. 450 (D. C. W. D. Pa., 1935). *Accord: Gibson* v. *Shufeldt*, 122 U. S. 27 (1887); *Handley* v. *Stutz*, 137 U. S. 366 (1890); *Towle* v. *American Building, Loan & Investment Society*, 60 F. 131 (C. C., N. D. Ill., 1894); *Taylor* v. *Decatur Mineral & Land Company*, 112 F. 449 (C. C. N. D. Ala., 1901).

Since this suit arises under a law of the United States, to wit, the Securities Act, and the matter in controversy exceeds the sum of $3,000.00, it follows that the District Court has jurisdiction by virtue of Section 24 (1) (a) of the Judicial Code.

(2) The suit arises under a law regulating commerce, to wit, the Securities Act. The Circuit Court concedes this, holding that the Securities Act "stems from the exercise of

Federal power under the commerce clause" (R. 383). Since the Securities Act is a law regulating commerce, it follows that the District Court has jurisdiction under Section 24 (8) of the Judicial Code.

For example, in a suit to restrain penalty deductions under the A. A. A., Mr. Justice Roberts said:

> "Tho' no diversity of citizenship is alleged, nor is any amount in controversy asserted, . . . the case falls within subdiv. 8 (*supra*)." Mulford *v.* Smith, 307 U. S. 38, 46 (1939).

In *Katz* v. *U. S. Shipping Board Emergency Fleet Corp., et al.*, 32 F. (2d) 14 (D. C. E. D. N. Y., 1929), the Federal court was held to have jurisdiction over an action for injuries to a visitor on a ship lawfully traversing a passageway on a pier, since the maintenance of wharves is a part of commerce and the action arose under a law regulating commerce. It was held that it was immaterial that the amount involved was only $1,000.00.

If a suit arises under a law regulating commerce, Federal courts have original jurisdiction under Section 24 (8) of the Judicial Code regardless of the amount in controversy: *Young & Jones* v. *Hiawatha Gin & Manufacturing Co.*, 17 F. (2d) 193 (D. C. Miss., 1927). The Court said, at p. 194:

> "If plaintiffs' declaration reveals a clear and substantial suit or controversy over the validity, construction or effect of a law regulating commerce, which will be defeated or sustained according to the construction given such law, the suit arises under the law regulating commerce and is one of which Federal courts have original jurisdiction."

See also *Willcox* v. *Consolidated Gas Co.*, 212 U. S. 19, 40 (1909); *Binderup* v. *Pathe Exchange, Inc., et al.*, 263 U. S. 291 (1923); *Atchison, T. & S. F. Railway Co.* v. *Kin-*

kade, 203 F. 165 (D. C. Kansas, 1912); *Illinois Central Railway Co.* v. *S. Segari & Co.,* 205 F. 998 (D. C. La., 1913).

(b) Jurisdiction Under the Securities Act.

Section 12 (2) provides: "Any person who . . . (2) sells a security . . . by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care, could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, *who may sue either at law or in equity* in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security."

Section 22 (a) provides: "The *District Courts of the United States . . . shall have jurisdiction . . . of all suits in equity* and actions at law brought to enforce any liability or duty created by this sub-chapter . . ."

Since the instant suit was brought, *inter alia,* to enforce the liability created by the Securities Act, the Circuit Court properly held that jurisdiction existed in the United States District Court.

(c) Summary of Jurisdictional Bases.

It is contended, therefore, that there exists here three separate bases of jurisdiction, as follows:

(1) Jurisdiction exists under Section 24 (1) (a) of the Judicial Code since there is present the jurisdictional amount of $3,000.00 and the suit arises under a law of the United States, to wit, the Securities Act.

(2) Jurisdiction exists under Section 24 (8) of the Judicial Code since the suit arises under a law regulating commerce, to wit, the Securities Act.

(3) Jurisdiction exists under Sections 12 (2) and 22 (a) of the Securities Act since this suit is brought to enforce a liability created by that Act.

III. The Jurisdiction So Obtained Includes the Power to Grant the Equitable Remedies Sought.

Plaintiffs submit that the District Court had power to grant equitable relief in this cause under any one or all of the three said bases of jurisdiction.

(a) Equitable Power Under the Judicial Code.

The Judicial Code expressly authorizes suits in equity. Section 24 (1) (a) provides in part as follows: "The District Court shall have original jurisdiction as follows: First. Of all suits of a civil nature at common law or *in equity* . . ."

Subdivision (8) of Section 24 provides: "Eighth. Of *all* suits and proceedings arising under any law regulating commerce."

The Judicial Code therefore authorizes this suit in equity; and the court had jurisdiction and power thereunder as a Federal court of equity, and independently of any additional powers granted by the Securities Act, to grant all appropriate equitable relief, including the appointment of a receiver.

In *Gordon* v. *Washington*, 295 U. S. 30, 36 (1935), speaking of "suits in equity" referred to in the Judicial Code, Mr. Justice Stone said:

> "The phrase has been understood to refer to suits in which relief is sought according to the principles applied by the English courts of chancery before 1789, as they have been developed in the Federal courts."

(b) EQUITABLE POWER UNDER THE SECURITIES ACT.

Section 12 (2) of the Securities Act provides: "Any person who . . . (2) sells a security . . . by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care, could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, *who may sue either at law or in equity* in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security."

Section 22 (a) provides: "*The District Courts of the United States . . . shall have jurisdiction . . .* of *all suits in equity* and actions at law brought to enforce any liability or duty created by this sub-chapter. . . ."

The Circuit Court decided that under the Securities Act the remedy of an aggrieved person lies exclusively in a "civil action" against the respondent vendor to recover

the "consideration" paid by him, and therefore held that none of the prayers of the complaint asking for specific relief may be granted.

District Judge Kalodner, however, in holding that the Securities Act confers jurisdiction upon the District Court, pointed out that under Section 12 of the Act, *the defendants are liable to the defrauded purchasers in the amount of the moneys paid in together with interest thereon* (R. 433); that the Act not only provides that "*District Courts shall have jurisdiction . . . of all suits in equity . . . brought to enforce any liability or duty created by this* [*Act*]" (R. 432), but that Section 16 provides that:

> "*The rights and remedies provided by this* [*Act*] *shall be in addition to any and all other rights and remedies that may exist at law or in equity*" (R. 433).

It is respectfully submitted that the quoted language can only mean that the Act authorizes the institution of any kind of suit in equity and any form of known equitable procedure necessary or proper to enforce any liability or duty created by the Act. Here the liability to be enforced is the recovery of the moneys due planholders. The implement provided by equity and invoked here to enforce that liability is a class bill seeking the appointment of a receiver. Obviously, such an action comes directly within the scope and meaning of the quoted language "*suits in equity . . . brought to enforce any liability*": see *Guffanti* v. *National Surety Company*, 196 N. Y. 452 (1909); *Cook* v. *Flagg*, 237 F. 426 (C. C. A. 2d, 1916); *Hollins* v. *Brierfield Coal and Iron Co.*, 150 U. S. 371 (1893); *Gordon, Secretary of Banking* v. *Washington*, 295 U. S. 30 (1935); *City Bond & Finance, Inc., et al.* v. *Grant*, 30 F. (2d) 671 (C. C. A. 8th, 1929).

Further, Section 12 of the Act is but a statutory type of equitable rescission of a contract; and, in all such cases, equity grants both rescission of the contract and, incidental

to the equitable relief, the return of the money involved. Equity thus grants a money decree. As stated in *Davis v. Rosenzweig Realty Operating Co.*, 192 N. Y. 128, 133 (1908):

> "The general rule governing the subject is well set forth in 24 Am. & Eng. Encyc. of Law (2d ed.) 615 as follows: 'Where the complainant in equity seeks to have a contract totally rescinded or declared void for fraud, the fact that he seeks also a recovery of the money is not sufficient ground for the refusal of the court to entertain jurisdiction; for in an action at law, the recovery of money is the principal object, while in a suit in equity the rescission of the contract is the principal matter of relief and the recovery of money is merely incidental although a necessary consequence; hence, the court being properly in possession of the cause for the purpose of granting purely equitable relief, will proceed to do complete justice between the parties, although a part of the relief granted is purely legal in its nature. . . .'
>
> "The plaintiff in this action . . . [brought] an action in equity to rescind and when rescission was decreed, he became entitled to full relief which included as an incident to rescission the recovery of the amount paid on the execution of the contract."

The Act specifically provides for suits both at law or in equity. It is highly probable that the Congress sought to provide the victim of fraud with every available judicial procedure for obtaining redress for his injury. Certainly, the Act should not be interpreted away to aid a fraudulent vendor, nor should the fact that money recovery may be the ultimate purpose of the suit defeat the victim's right to the aid of a court of equity. For example, if a debtor is insolvent and indulging in dissipation and waste, if equitable jurisdiction is present, equity will take jurisdiction and apply its immunizing powers to the assets of the debtor notwithstanding the fact that in essence the creditors are

merely money claimants who are seeking the highest possible monetary return on their claim. The principle involved is just as applicable in the instant case.

Section 12 of the Securities Act should therefore be construed to permit a defrauded purchaser to recover his money, and for that purpose, to permit the utilization of all the powers of a court of equity, whenever they become necessary, to safeguard the victim's interests. Such a construction, in fact, appears to be the only rational explanation for the insertion of the clause "all suits in equity and actions at law" and would most effectively help defrauded victims and discourage violations of the Act.

(c) Power to Appoint Receiver Not Dependent on Statute

It is well settled moreover that the power of the Federal courts to appoint receivers is inherent in Federal equity jurisdiction and does not depend on statute. As stated in *Alderson's Beach on Receivers* (1905) pages 71, 15, 16:

> "The power of a court of equity to appoint a receiver in cases which come within those principles which make its duty inherent is exercised without the necessity for statutory authority and is in fact independent of statute. . . . The appointment of receivers having originated in the court of chancery in England . . . the power of appointment has naturally and regularly descended to all courts which have jurisdiction in equity. It is inherent in courts of equity. . . . The courts of the United States retain and exercise all the chancery powers originally granted to them by the Process Act of 1792, by which the principles, rules and usages of the English court of chancery were adopted in proceedings in equity. Among these powers is that of appointing receivers, a function which is frequently exercised."

This Court said in *Payne* v. *Hook*, 7 Wall. 425, 430 (1868):

"The equity jurisdiction conferred on Federal courts is the same as the high court in chancery in England possesses . . ."

In *6 Cyc. of Federal Procedure* (Langsdorff, 1929), Section 3329, it is said:

"If the Federal court has jurisdiction as a Federal court, the next question is as to its equity jurisdiction to appoint a receiver, and as to this it is held that its power is inherent. . . . '

As stated in *Road Improvement District No. 7* v. *Guardian Savings & Trust Co.*, 298 F. 272, 274 (C. C. A. 8th, 1924):

"The general power to appoint receivers, in proper cases and under proper circumstances, inheres in Federal equity jurisdiction."

In *U. S.* v. *McCutcheon*, 234 F. 702, 715 (D. C. of Cal., 1915) the court said:

"The appointment of a receiver is made by a court of equity in the performance of one of its prerogative functions. . . ."

In *Tardy's Smith on Receivers* (1920, p. 1, Section 1 it is said:

"The power to appoint receivers is one referable solely to the powers exercised by courts of chancery . . . the power to appoint a receiver *pendente lite* has been exercised by courts of chancery as incidental to their jurisdiction. It has not been deemed to depend upon statute."

See also *I Clark on Receivers*, pp. 50, 52; *Decker* v. *Gardner*, 121 N. Y. 334 (1891); *In re Penny*, 10 F. Supp. 638, 640 (D. C. N. C. 1935).

It is to be noted that the Circuit Court, in the instant case, based its holding that the District Court had no power to appoint a receiver in these proceedings upon the absence of any provision therefor in the Securities Act of 1933.

If the absence of such provision in the statute were sufficient ground for denying such power to a District Court, then no appointment of a receiver by a Federal court of equity is valid, for there is no Federal statute, except the bankruptcy laws, granting to a Federal court the power to appoint a receiver. We are concerned here, however, not with receivers in bankruptcy, but with equity receiverships.

Furthermore, the only provisions existing in the Federal statutes relative to equity receivers impliedly recognize the *inherent* power of the courts to appoint them. There are only four such provisions in the Federal statutes as follows (*6 Cyc. of Federal Procedure* (Langsdorff, 1929) Sec. 3315):

(1) Management of receivership property by receivers in accordance with State laws (Judicial Code, Sec. 65; Act of March 3, 1887, c. 373, Sec. 2, 24 Stat. 554, as amended; 28 U. S. C. 124).

(2) Control by receiver of property outside the district, but within the judicial circuit (Judicial Code, Sec. 56; Act of March 3, 1911, c. 231, Sec. 56, 36 Stat. 1102; 28 U. S. C. 117).

(3) Leave of court to sue receiver (Judicial Code, Sec. 66; Act of March 3, 1887, c. 373, Sec. 3, 24 Stat. 554, as amended; 28 U. S. C. 125); and

(4) Eligibility of particular officers to act as receivers (Judicial Code, Sec. 68; Act of March 3, 1879, c. 183, 20 Stat. 415, 28 U. S. C. Sec. 127; and Act of May 28, 1896, c. 252, Sec. 20, 29 Stat. 184, 28 U. S. C. Sec. 527).

Since the Federal courts have constantly and frequently, since their creation, appointed receivers in equity without objection: since there is no Federal statute granting such power to the Federal court: it follows *a priori* that the power is inherent in the courts themselves, and does not, and need not, flow from statute. It is most respectfully urged, therefore, that the Circuit Court erred in holding that plaintiffs were not entitled to the appointment of a receiver and that the Securities Act did not enlarge the rights of the plaintiffs to such appointment.

Moreover, it is well settled that where a plaintiff is granted a right of action by statute, he may, in order to implement and effectuate that right of action, demand and obtain ancillary equitable relief. Included in such ancillary equitable relief is the appointment of a receiver: *Ireland* v. *Nichols*, 3[illegible] N. Y. Super, 208 (1869); *Roper Lumber Co.* v. *Wallace*, 93 N. C. 22 (1885); *People* v. *N. Y.*, 10 Abb. Pr. 111 (1858); *Hickman* v. *City of Kansas*, 120 Mo. 110 (1894).

(d) THE EQUITABLE REMEDIES SOUGHT ARE NECESSARY AND APPROPRIATE.

Plaintiffs may maintain the instant class action under Rule 23 (a) of the Federal Rules of Civil Procedure since the persons constituting the class are so numerous as to make it impracticable to bring them all before the court, the character of the rights sought to be enforced for the class is several, the object of the action is the adjudication of claims which affect specific property involved in the action, there are common questions of law and fact affecting the several rights, and a common relief is sought, *Everglades Drainage League, et al.* v. *Broward Drainage District, et al.*, 253 F. 246 (D. C. Fla., 1918); *Gramling* v. *Maxwell*, 52 F. (2d) 256 (D. C. N. C., 1931).

A class suit has been defined in *Seminole* v. *Southern*, 182 F. 85, 96 (C. C. E. D. N. C., 1910) as follows:

"One in which one or more members of a numerous class having a common interest sue in behalf of themselves and all other members of that class. Such suits are sometimes called 'creditors' suits' and sometimes 'stockholders' suits.'"

The appointment of a receiver in a class action is common. As stated in 15 C. J. 1449:

"It is a well established practice to appoint a receiver of defendant's property in aid of a creditors' bill whenever it appears that the property is in peril or in danger of waste, especially . . . ."

See *Shainwald* v. *Lewis*, 6 F. 766 (D. C. Cal. 1881).

In *Gramling* v. *Maxwell, supra,* a suit was brought to enjoin the enforcement of a tax by the complainant on behalf of himself and others similarly situated, alleging that at least 400 other persons were in the same plight and condition that he was. The defendant argued that the taxing Act provided for the payment of the tax under protest and suit for its recovery and that, therefore, there was an adequate remedy at law. The court stated first that if merely a single taxpayer were involved this remedy at law would probably be adequate but since a multiplicity of suits was inevitable, a class suit was proper. The court said at p. 260:

"It is speedier, more efficacious and more satisfactory for all parties concerned than the institution of 100 or more actions at law for the recovery of taxes paid under protest. The remedy provided by the statute cannot, therefore, in view of the situation, be deemed an adequate remedy as compared with suit in equity which eliminated so much useless and cumbersome litigation."

Applicable here too is the well-settled doctrine that a court of equity which has assumed jurisdiction of a controversy on any ground or for any purpose will retain such

jurisdiction to grant complete relief (*Ward* v. *Todd,* 103 U. S. 327 (1880); *Ober* v. *Gallagher,* 93 U. S. 199 (1876); *Siler, et al.* v. *Louisville and Nashville Railroad Company,* 213 U. S. 175 (1909); *U. S. Navigation Co., Inc.* v. *Cunard S. S. Co.,* 284 U. S. 474 (1932); *Hart Coal Corp., et al.* v. *Sparks,* 9 F. Supp. 825 (D. C. W. D. Ky., 1935), to avoid multiplicity of suits (*U. S.* v. *Union Pacific Railway Co., et al.,* 160 U. S. 1, 50 (1895)), and to do entire justice with respect to the subject matter of the controversy (*De Bemer* v. *Drew,* 57 Barb. (N. Y.) 438 (1870)), whether the question is one of substance or remedy (*Gwinn* v. *Lee,* 6 Pa. Super., 646 (1898); *McGowin* v. *Remington,* 12 Pa. 56 (1849)).

In the instant case, if all 20,000 planholders brought individual suits against the defendants, seeking to rescind the trust, protect the trust *res* from dissipation and waste, and recover the consideration paid by them for the securities, each planholder separately would prove the same general and all-pervasive fraud which plaintiffs, on behalf of all, have already proved in this case. Equity must therefore take jurisdiction to avoid the threatened and probable multiplicity of suits and to do entire justice with respect to the subject matter of the controversy. Complete and final relief will thus be given 20,000 planholders by means of a single judicial decree.

Moreover, since the defendant vendor is insolvent and unable to satisfy in full the claims of planholders, it is futile to argue that the only proper remedy of a defrauded planholder is an action at law when it is probable that, by the time the judgment is obtained, execution thereon would be fruitless and of no practical utility. In addition, such course of procedure would create preferences in favor of those planholders who were fortunate enough to secure the first judgments. It is therefore submitted that the proce-

dure of the instant case is the only just and equitable method of determining and enforcing the rights of all planholders without preference or discrimination. See *Case* v. *Beauregard*, 101 U. S. 688 (1879).

Since the contract certificates and purchase plans are void because of fraud, the trusts created thereby are also void and, as stated in *Case* v. *Beauregard, supra*, at 691:

> "Whenever a creditor has a trust in his favor . . . he may go into equity without exhausting legal processes or remedies."

See also *Oelrichs* v. *Spain*, 82 U. S. 211 (1872); *Wyman* v. *Wallace*, 135 F. 286, 292 (C. C. A. 8th, 1904).

What has been said above should effectually dispose of appellees' contention that there is an adequate remedy at law.

Since the trust assets are in danger of loss from waste, misconduct and the insolvency of the defendant vendor, the appointment of a receiver is proper: *International Trust Company* v. *Decker Brothers, et al.*, 152 F. 78 (C. C. A. 9th, 1907).

The court, and only the court, can take possession of the assets of the now avoided trusts for liquidation and distribution to persons properly entitled thereto (opinion of Kalodner, J., R. 351, Trusts Restatements, Sec. 199, Chap. 7).

In *Pusey & Jones Co.* v. *Hanssen*, 261 U. S. 491, 497 (1923), it was said:

> ". . . the appointment of a receiver is merely an ancillary and incidental remedy. A receivership is not final relief. The appointment determines no substantive right. It is a means of preserving property which ultimately may be applied toward the satisfaction of substantive rights."

In *Alderson's Beach on Receivers* (1905), page 72, it is said:

> "The primary purpose in all circumstances in which a receiver is appointed, is to protect and safeguard the property which is the subject matter of the litigation where there is no other adequate method of doing so in order that the work of the court in determining the litigation will not be an idle ceremony."

The appointment of a receiver here effectuates these purposes precisely; he would preserve the trust funds so that the rights of planholders may be ultimately satisfied out of their proceeds.

In *Cook* v. *Flagg*, 233 F. 426 (C. C. A. 2d, 1916), the defendant Flagg, not a member of the Stock Exchange, devised a fraudulent scheme for speculating in stock. On the faith of his representations, the plaintiff and many others entrusted him with their money to the extent of an estimated aggregate of $1,000,000.00. The complaint prayed for a preliminary injunction, the appointment of a receiver, an ascertainment of the claims to the fund remaining in the defendant's hands, and an appropriate distribution. In appointing a receiver, the Court held that the defendant had acquired possession of the money of others through misrepresentations and that he was therefore a trustee *ex maleficio* and that the appointment of a receiver was the proper remedy. Inasmuch as participation in the fund was to be shared by many people similarly situated, a receiver was necessary in order to effectuate a just distribution.

See also *Wyman v. Wallace*, 135 F. 286 (C. C. A. 8th, 1904), affirmed 201 U. S. 230 (1906); *Merchants' National Bank, et al.* v. *Chattanooga Construction Co.*, 53 F. 314, 317 (C. C. E. D. Tenn., 1892); *Gordon, Secretary of Banking* v. *Washington*, 295 U. S. 30 (1935); *III Scott on Trusts*, Section 468; *II Clark on Receivers*, Section 1007.

As alleged in Paragraph 54 of the complaint, the prayer for the appointment of a receiver is proper, and the granting of such relief necessary, for the following reasons (R. 26, 27):

(a) Independence Shares Corporation is insolvent and unable to meet its liabilities.

(b) A proper accounting can be undertaken only by a receiver appointed by the Court and not by agents and accountants dominated by the defendants.

(c) The appointment of a receiver will prevent the threatened and probable multiplicity of suits.

(d) The appointment of a receiver will prevent further dissipation, depletion and waste of assets equitably belonging to planholders and will preserve and safeguard the said assets.

(e) The appointment of a receiver will prevent inequitable preferences and will result in the division of all assets equitably among the persons entitled thereto without the necessity of further litigation.

(f) The liquidation and equitable distribution of the assets belonging to planholders should be undertaken only by an officer or representative of the court.

It is, therefore, respectfully submitted that not only is a class bill for the appointment of a receiver authorized and intended by the Judicial Code, the Securities Act, and general equitable principles, but that it is the most appropriate form of equitable procedure applicable to the factual pattern of the instant cause.

IV. The Pennsylvania Company is a Necessary Party Defendant.

The Circuit Court held that, since the recovery of petitioners is limited to a money judgment, it follows that the

Pennsylvania Company was not a proper party to the suit (R. 383-384).

Neither the Pennsylvania Company nor the other respondents nor the Circuit Court challenge, dispute or deny the findings of the learned District Court that the contract certificates, purchase plans and trust shares which created the trust fund of which the Pennsylvania Company claims to be trustee, were induced and procured by flagrant fraud on the part of Independence Shares Corporation, its predecessor Capital Savings Plan, Inc., and their officers.

The money paid by defrauded planholders and securities purchased therewith constitute the corpus of the trust fund. The Pennsylvania Company claims the Court is powerless to protect this fund for these victims simply because it, the trustee, alleges it has not been guilty of any fraud or wrongdoing.

If the Circuit Court is correct in holding that the Pennsylvania Company is not a proper party to this suit, it means that the law is powerless to reach a trust estate procured and created by fraud.

Naturally, the law is otherwise. Nothing is more settled in the law than the principle that what fraud creates, equity will destroy. *Bogert, in Trust & Trustee,* Section 992 says, "If the trust declaration or transfer is procured by a wrongful act of the trustee, *cestui que trust* or third party, the settlor, or his successors in interest, may have it set aside in equity."

In *Migely* v. *Migely,* 162 Ill. App. 300 (1911), it is said, "Chancery will take jurisdiction to set aside a trust agreement, the execution of which was induced by fraudulent representations."

In 65 Corpus Juris, page 332, it is said "an instrument purporting to create a trust is voided when its execution is procured by fraud, and it may be set aside", and on page

337, "where the execution of a trust is procured by fraud, equity may set it aside."

See *Ricks' Appeal*, 105 Pa. 528 (1884); Note, 38 A. L. R. 977; *Gill's Trustee, et al.*, v. *Gill, et al.*, 124 S. W. (Ky.) 875 (1910).

It follows, therefore, that participation in the fraud by the trustee is immaterial.

In addition, the Pennsylvania Company, under the trust agreements, is in reality not a trustee but simply a custodian and bookkeeper. It has neither the powers nor the obligations of a trustee concerning the corpus of the trust. All control, management, investment and reinvestment of the corpus is specifically vested in Independence Shares Corporation (Opinion of Kalodner, J., R. 359). Really, the Pennsylvania Company's only function is to keep the funds and the records. In fact, throughout the trust agreement, the Pennsylvania Company zealously guards itself against any responsibility or liability by reason of the control or management of the trust. In addition, under the trust agreements, Independence Shares Corporation reserves the right at any time, for any reason, to discharge the Pennsylvania Company as so-called trustee and appoint a substitute trustee.

Hence the Pennsylvania Company's argument that the trust can not be avoided because it claims that it, as trustee, was not guilty of fraud, is not applicable here because the fact is that the real trustee is not the Pennsylvania Company, but Independence, who admittedly is guilty of fraud.

It follows that if the trust is not terminated, the trust assets, even though nominally in the possession of the Pennsylvania Company, will actually be administered, managed and controlled by Independence, the insolvent perpetrator of the fraud.

At the inception of these proceedings, no charges were made against the Pennsylvania Company because plaintiffs deemed the making of such charges irrelevant and unnecessary. Since the Pennsylvania Company, however, contends that it is unnecessary for the Court to appoint a receiver because it is the proper person to retain and manage the trust corpus, it becomes necessary to review the conduct of the Pennsylvania Company.

It may be, of course, that the Pennsylvania Company even though it had means of knowledge, had no actual knowledge, prior to the commencement of the litigation two years ago by the Securities and Exchange Commission, of the fraud perpetrated by Independence. It may be, too, though improbable, that the Pennsylvania Company was unaware of the existence of the fraudulent prospectuses which contained misleading and untrue statements concerning the activities and functions of the Pennsylvania Company with respect to the investment of the moneys and the operations of the trusts.

It is obvious, however, that since the institution of the bill in equity by the Securities and Exchange Commission and the proceedings by the plaintiffs herein, particularly after testimony was taken and the District Court made its undisputed findings of fact, that the Pennsylvania Company had full and complete knowledge that:

(a) the stock selling scheme was fraudulent and the beneficiaries, for whom the Pennsylvania Company purports to act as trustee, had been victimized;

(b) the functions and activities of the Pennsylvania Company with respect to the control and management of the trust had been misrepresented by Independence;

(c) the name, reputation and responsibility of the Pennsylvania Company had been used as bait for unwary purchasers;

(d) the load imposed on the trust by Independence was too great for any trust to carry and therefore the stock selling scheme was hopelessly foredoomed to failure; and

(e) Independence is insolvent and therefore unable to satisfy the claims of all subscribers.

It is submitted that the clear duty of a trustee under such circumstances was promptly to divest itself of association with the fraudulent vendor, to do all things required to be done to protect the property and rights of its beneficiaries, and to notify the beneficiaries that they had been misled and defrauded. Likewise, it should have notified those subscribers who purchased plans because they were informed and had believed that the Pennsylvania Company managed, sponsored and was "in back of" the plan, that the Pennsylvania Company was in reality not a trustee but simply a custodian and bookkeeper, and that Independence could, at any time, discharge the Pennsylvania Company as so-called trustee and appoint a substitute trustee.

The Pennsylvania Company, however, did none of these things. On the contrary, it still pays to Independence the excessive charges exacted by Independence under the void trust certificates. It is vigorously contesting these proceedings. It fought Judge Kalodner's order restraining the Pennsylvania Company from paying to Independence the fund of $38,258.85.

The record shows, and the Pennsylvania Company admits, that it receives a monthly trustee fee of 25¢ from each of the 18,000 planholders on each payment of $10 or a fraction thereof (R. 54, 63; Brief of the Pennsylvania Company in the Circuit Court, p. 39).

The question may now fairly be asked whether the Pennsylvania Company is now acting in its own interests or in

the interests of the victimized planholders for whom it claims to be trustee.

It is respectfully submitted that that question has but one possible answer; and that answer compels the conclusion that the Pennsylvania Company should not be permitted to maintain or administer the trust assets.

In addition, the Pennsylvania Company may not retain or administer the trust assets because it does not have the status of any equity receiver responsible to the court. As stated by Judge Kalodner (R. 350, 351):

> "Passing now to the similar motion to dismiss on behalf of The Pennsylvania Co. &c., it is sufficient to say that this case differs entirely from that of Gordon *v.* Washington, 295 U. S. 30. There, the Secretary of Banking had taken over a bank, and the Supreme Court held specifically that 'The Secretary has the status of an equity receiver responsible to the court' in which he had filed a certificate of possession. True, there is no charge here that The Pennsylvania Company, &c., has been guilty of any misconduct, neglect or mismanagement and no testimony thereof. The Pennsylvania Company, &c., however, has *not* the status of an equity receiver responsible to any court. And, if the funds in its hands are to be preserved or distributed for creditors in the instant proceeding, that must be done by an arm of the court—a receiver appointed by the court and responsible to it."

V. The Order Safeguarding the $38,258.85 Was Proper.

This was an order entered during the process of litigation for the preservation and protection of property in litigation and rights therein.

Since Judge Kalodner found that the charges which this sum represents were not only concealed from plannholders, but were deliberately misrepresented to them (R. 361, 362), the fund belongs to planholders and must be protected from

dissipation by Independence. In addition, since it is apparent that Independence is insolvent (R. 333-336, 362), this fund should be retained by the court and used to satisfy claims of defrauded planholders.

Such an order is reversible only for abuse of discretion: *Kings County Raisin & Fruit Co., et al.,* v. *U. S. Consolidated Seeded Raisin Company,* 182 F. 59 (C. C. A. 9th, 1910); *Minerals Separation Company* v. *Miami Copper Company,* 269 F. 265 (C. C. A. 3d, 1920); and since Independence neither challenges, disputes nor denies the facts on the basis of which the learned Chancellor entered the said order enjoining the receipt by it of the $38,258.85, the order is proper; the learned Chancellor abused no discretion in making it; and it should be sustained irrespective of the question whether the Pennsylvania Company is or is not a proper party defendant.

All of which is respectfully submitted.

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Dated ——, 1940.

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